

Changing how we define the scope of regulated financial advice

April 2017

HM Treasury published their response to the Consultation on "Amending the definition of financial advice" and alongside this the FCA have issued an explanatory note. Whilst the change will help authorised firms provide more extensive and better guidance services, arguably the proposals do not go far enough and some of the implications may not been fully thought through.

Background

It should be acknowledged that the wide ranging scope of regulated investment business activities in the UK, originally set in a 1986 Act and still retained within the Regulated Activities Order made under the Financial Services and Markets Act 2000, has proved extremely durable. Over the years there have been various areas of mismatch; notably ISD and MiFID 1 and now prospectively MiFID 2 have been implemented on top. The basic elements though of the wide scope of investment business regulated activities remains unaltered – as they are originally set down in the 1980s.

One aspect of mismatch on which HM Treasury do now intend to take action concerns amending the definition of financial advice so as to bring the Article 53 Regulated Activities Order text relating to advising on investment more in line with the MiFID 1 provisions regarding personal recommendations.

HM Treasury launched an initial Consultation on regulation of financial advice in September 2016.

This consultation picks up on one recommendation from the joint HM Treasury/FCA Financial Advice Market Review ("FAMR"). The objective was formulated as a result of a number of factors including:

- The FAMR review had picked up on the confusion regarding the boundary between what was regulated investment advice and what was not (hence the FCA's paper purporting to clarify this – now FG15/1 which in fact probably clarified very little).
- Aside from confusion on the boundary of the definition, there is a much wider set of concerns arising from the unintended consequences of implementation of the FCA's RDR initiatives. There is increasing recognition that individuals are ceasing to seek investment advice.

- Distinct from regulatory issues, there have been numerous developments in the possibilities for offering guidance and advisory services – with for example, model portfolios, electronic offerings and AI for example. How should some of the more modern approaches be dealt with within the regulatory net?

As is frequently the case however there are particular UK regulatory concerns – and particularly with regard to investor protection – which mean that the progress on this proposal will not be as entirely straight forward as might have been thought.

HM Treasury has now issued its [Consultation Response](#) of 27 February 2017 and the FCA have published a short [explanatory note](#) alongside this Response summarising the new requirements and the implications for regulated and non-regulated firms.

HM Treasury have confirmed that they are proceeding with the proposal.

The Government rightly take the view that they want to ensure "that people have access to financial advice and guidance at all stages of their life in order to help them make informed financial decisions. The regulatory framework should not inhibit firms from delivering guidance services that can support consumers in this".

Changes to the proposals

As originally proposed, a simple change to the definition would have been introduced which would have changed our UK Article 53 RAO definition of advising on investments to match the MiFID 1 definition of a personal recommendation.

As finalised, the old and familiar scope of Article 53 will not be removed altogether. It will be retained as the boundary for whether a firm requires authorisation. HM Treasury, in response

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to numerous comments, has modified its proposals so that there will be a two layer structure:

- for regulated firms. the change to definition is to be made such that the regulated activity will only cover personal recommendations;
- for unregulated firms however, the existing wider Regulated Activities Order definition of "advising on investments" will remain in place.

This change of approach demonstrates the Government's continued focus on protecting consumers. As the February 2017 HM Treasury paper states:

"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."

As a consequence, regulated firms will have greater certainty in devising more advanced guidance services – as was always the intention. Unregulated firms will not however be able to offer these more detailed and tailored guidance services.

Will the changes improve available guidance services?

This new approach to defining financial advice will be an improvement on the current regime but probably not offer a complete solution.

This initiative should encourage authorised firms to provide much more help to consumers than they have been able to do in the past and with greater confidence.

The longstanding concerns about complying with suitability requirements if one steps over the line into advising on investments has precluded many established firms from providing helpful tools which could usefully steer clients towards certain destinations, whether in general terms or more specifically with model portfolios or particular actions in respect of investments.

With the proposed change moving the boundary line of the regulated activity quite markedly by limiting the scope of regulated investment advice to that under MiFID should be a considerable help. It should create greater confidence for authorised firms in improving their various information and guidance tools for customers and potential customers. The longstanding issues with the existing boundary certainly had some over technical constructions. Firms may have greater confidence

when some of the over-technical constructions of the old regulatory boundary cease to be a problem, and so free up firms to be more creative in how they can help consumers understand the nature of the types of investments and the investment products which can help meet investors' needs.

Some authorised firms will likely be encouraged to try and fill the void which the FAMR Report identified, particularly given:

- an increasing reluctance particularly from individuals to turn to IFAs to provide specific advice on a regular basis; and
- the increasing need for investors to consider their short and long term financial future – and in particular to acknowledge their responsibility for their long term savings plans for retirement, given, in particular, the switch of the risk for their pension arrangements in particular to them with some form of DC, and increasingly personal, arrangements.

Continuing impact of regulation for guidance services

Firms should not view guidance services as entirely unregulated. Removing such activities from the scope of regulated activities for authorised firms does not mean they are removed entirely from the scope of regulation – the FCA impose high standards on regulated firms for all their activities.

Also there are interesting questions as to how these new services will be formulated:

- For example, firms are permitted to charge for guidance services but most of these services are currently offered for free (not least because they are being offered in circumstances where generally consumers might be unwilling to pay for guidance) and there is no proposal to ban charges for guidance services.
- As HM Treasury point out in their February Consultation Response document, implicit as well as explicit recommendations can still come within the scope of MiFID investment advice. So some debates will continue – just on a different boundary.

Will new guidance service providers be encouraged?

There is a risk that HM Treasury and the FCA have created a new problem. The two layer structure may inhibit new entrants to the market place.

It is clear that the Government has decided that unauthorised firms should not be able to offer guidance services. What is less clear is what the position will be for new entrants to the market

place who seek authorisation and then in fact only carry on activity which is taken outside of the scope of regulated activity for an authorised firm to conduct. This could have some unusual challenges for those seeking to obtain authorisation simply to provide guidance services.

The initial statement about these changes published on 27 February by the FCA does not refer to this issue. It simply indicates for unregulated firms and individuals "no change – these firms and individuals will not be able to provide any form of regulated advice". We are not sure what the FCA's approach will be for a new guidance service provider if its services will be limited to guidance services – and whether the working assumption is that such a provider will usually also carrying on other regulated activities.

Certainly the dual regulatory approach is a positive decision taken by HM Treasury which may deliberately limit the number of and nature of the firms which can help achieve the objective of ensuring people have access to financial advice and guidance effectively.

Will the change remove confusion?

Finally, given the confusion of the various definitions at the moment, is it likely that these changes will help?

One element of comfort is provided by the Government's change of proposal such that these new guidance services will be provided by authorised firms, so consumers should take comfort from the fact that these services are provided by regulated firms.

There is however a risk that we will end up with consumers still being confused as to what is regulated and what is unregulated when they see the services simply as coming from a regulated firm. It may be that this does not matter: the fact is that this Government initiative will encourage a wider range of services to be made available by authorised firms, and the more onerous requirements will not apply to them – only to personal recommendations. Nonetheless, the Financial Advice Working Group is developing new consumer friendly terms to describe advice and guidance services. We should hope that they keep them simple.

FCA Guidance Consultation 17/4

This change in the investment advice definition has also to be considered in conjunction with the FCA's additional work in implementing other FAMR recommendations. In this connection, see our Briefing Paper regarding FCA's Guidance Consultation GC 17/4.

Timing

A statutory instrument is expected to implement the investment advice definition change soon, with the definition coming into effect on 3rd January 2018.

The FCA will be publishing new guidance (and considering alignment with its plans for MiFID II). An FCA Consultation is expected later in 2017. Certainly we need to have sight of the FCA's revisions to their Guidance FG 15/1.

One could sympathise if authorised firms welcome this initiative but wait a little while before developing any new business models for guidance products until they have seen a revised position set out by the FCA.

Contact



Kirstene Baillie

Partner

E: Kirstene.Baillie@fieldfisher.com

T: +44 (0)20 7861 4289



Nicholas Thompsell

Partner

E: Nicholas.Thompsell@fieldfisher.com

T: +44 (0)20 7861 4292

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