15 December, 2020

Financial Conduct Authority
12 Endeavour Square
London E20 1JN

Submitted by E-mail to: ConsumerInvestmentsCFI@fca.org.uk

Dear Consumer Investments Team,

CFA UK response to the FCA's Call for Input: The Consumer Investments Market

CFA Society UK ("CFA UK") welcomes the opportunity to participate in this wide-ranging Call for Input ("CfI") on the UK's Consumer Investments Market.

CFA UK is the professional body that serves nearly 12,000 leading members of the UK investment profession. Many of our members work with in the UK consumer investments markets, either in managing retail investment funds or in advising clients directly on investments. Of course, our Society and its umbrella organisation, CFA Institute, are heavily involved in the provision of financial education to investment professionals in the UK and globally providing a range of examination programmes, curricula and course-work materials[1].

Whilst the full range of topics in the CfI will be of interest to our membership, at this stage CFA UK has addressed just those questions directly or indirectly relating to financial education. Financial education (formal and informal) is the core activity of our Society and the basis of our mission to build a better investment profession by raising overall levels of financial understanding and knowledge within it. You will find our detailed answers to the relevant questions in Appendix II. We look forward to participating in future consultations around the various specific topics.

Yours sincerely,

Will Goodhart,
Chief Executive
CFA Society of the UK

Andrew Burton
Professionalism Adviser
CFA Society of the UK

With thanks to the oversight of the Professionalism Steering Committee

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[1] *More details on CFA UK and the CFA Institute are provided in Appendix I.*

CFA Society United Kingdom

Appendix I: About CFA UK & the CFA Institute

CFA UK: serves nearly 12,000 leading members of the UK investment profession. Many of our members work with pension funds, either managing investment portfolios, advising on investments or as an in-house employee responsible for pension investment oversight.

- The mission of CFA UK is to build a better investment profession and to do this through the promotion of the highest standards of ethics, education and professional excellence in order to serve society's best interests.

- Founded in 1955, CFA UK is one of the largest member societies of CFA Institute (see below) and provides continuing education, advocacy, information and career support on behalf of its members.

- Most CFA UK members have earned the Chartered Financial Analyst® (CFA®) designation, or are candidates registered in CFA Institute's CFA Program. Both members and candidates attest to adhere to CFA Institute's Code of Ethics and Standards of Professional Conduct.

CFA Institute: is the global association of investment professionals that sets the standard for professional excellence and credentials.

- The organization is a champion for ethical behavior in investment markets and a respected source of knowledge in the global financial community. The end goal: to create an environment where investors' interests come first, markets function at their best, and economies grow.

- CFA Institute awards the Chartered Financial Analyst® (CFA), and Certificate in Investment Performance Measurement® (CIPM) designations worldwide; publishes research; conducts professional development programs; and sets voluntary, ethics-based professional and performance-reporting standards for the investment industry.

- There are more than 175,000 CFA® charterholders worldwide in 165+ countries and territories. CFA Institute has eight offices worldwide, and there are 158 local member societies.

- For more information, visit www.cfainstitute.org or follow us on Twitter at @CFAInstitute and on Facebook.com/CFAInstitute.

Appendix II: RESPONSES TO QUESTIONS

Chapter 1: Executive Summary

Q1: Have we prioritised the right issues and questions? Are there other things that you think we should be looking at?

- We would add further emphasis to what is described in Section 2 and what we term 'Behavioural Finance': the importance of how the behaviours of retail investors differ (to a degree) from the psychology of investment professionals (and regulators). Investment professionals and regulators tend toward the analytic, persuaded by data and logic. Retail investors are for the most part less analytical – lacking either the time, the skills or both. More disclosure will not help people whose decision-making is motivated primarily by emotion or by what everyone else is doing. Financial education in a form that teaches retail investors the right skills in a time-efficient way and free of bias should be, we think, a core component of the FCA's strategy to address the problems discussed in this paper.

Chapter 2: The Consumer perspective

Q2: Are there other underlying issues which have an impact on the consumer experience in this market that you think we should consider? What are they and how do you think they affect consumers?

- We perceive that one important aspect of the problem is that there is no such thing as 'the retail consumer'. The consumer finance market is made up of a range of types of individual which behave and think very differently as well as having very different needs.
- For example, the needs and proclivities of investors differ by more than life stage and wealth/income. The lived experience of their cohort when they were in the formative late teens - early thirties years (e.g. an era of high inflation vs an era of low inflation) shapes their attitude toward risk for the rest of their lives. Any new regulation should take the range of different 'reasonable' attitudes into account; perhaps consumers need also to be encouraged to think more about their own attitudes, how they compare with others and what the consequences may be.
- One way to achieve this would be to ask investors to think about acceptable investment outcomes, rather than asking them to label their attitudes as 'low', 'medium' or 'high' risk. In practice most consumers consider their risk appetite to be 'medium' but this transpires to cover a wide range of actual risk tolerance.

CFA Society United Kingdom

Q3: What role could or should 'just in time' consumer education play in helping consumers make more effective investment decisions?

- We would agree with the FCA's perception that, in reality, all consumer investment decisions are not made in a school classroom but in amongst the hurly burly of everyday life. In this reality, emotions typically play a larger role and immediate needs can often overcome long-term planning. In this sense, whilst surprised at the overwhelming nature of the evidence and conclusion presented in the meta-analysis, we can empathise with the FCA's conclusions which lead from it.
- However, if just-in-time education is going to be seen as the answer, CFA UK believe strongly that it is critical that it should come from an independent and neutral source and NOT the provider of the product. Just as patients naturally trust their doctor, so students place their teacher in a position of trust and this can be easily abused if the salesman is allowed to also fulfil the role of educator.
- Such education also should be freely available to all consumers yet needs to be tailored to the ability of each consumer to access it. This means provision of product education presented in different tiers – for example, basic, intermediate and advanced as equivalent to high-school, sixth-form and degree level – so that consumers can access what works best for them considering the time they have available and their ability to absorb it.

Chapter 3: Making the mass market work well

Q8: Do you think financial guidance can help consumers make effective investment decisions? Why?

- We perceive that general, non-personalised guidance could be useful in some product areas, such as investments where there is such a range of options available which need to be narrowed down in a logical sequence, according to the consumer's individual needs. In many ways a version that finishes the journey by pointing to a narrow range of appropriate products rather than a specific solution is not dissimilar to the "just-in-time education" considered in question 3.
- In principle, CFA UK strongly support automated robo-guidance, provided there is complete transparency about the inputs considered (and not considered) and the algorithms deployed, so the consumer can 'play around' to see how the advice would change if s/he altered his or her inputs. We would caveat that remark with the observation that many older consumers do struggle with online products so this will not be a complete solution unless some form or human support is also provided.
- It is vital that any such robo-guidance is consumer tested and CFA UK would also consider the FCA's Sandbox regime appropriate here. Whilst the robo-guidance journey

must be complete enough to consider all of a consumer's relevant circumstances, it must not be too time-consuming for consumers and easily and logically navigable (which some on-line versions provided by firms are not).

Chapter 4: Higher Risk Investments

Q19: How can we better ensure that those who have the financial resources to accept higher investment risk can do so if they choose, but in a way that ensures they understand the risk they are taking?

- The principles behind the existing regime are that high risk investments should only be available to those consumers that (i) can afford to lose potentially all of the value of their investment and (ii) those that have a sufficient understanding of the risk involved in such investments.
- As we observe in our answer to question 23 below, however, CFA UK believes the current rules around investors participating in high risk investments could be better tailored to meet these principles.
- CFA UK also believes that risk as a concept is dynamic and therefore that the FCA should keep the definition of "high risk" under review. For example, in a potential scenario of low or negative interest rates, coupled with high inflation, a "low-risk" investment designed to preserve capital in purely nominal terms may still prove to be a relatively poor investment in real-terms.
- Very simply, CFA UK would advocate that:
    - A "High Net Worth" investor should be required to get the sign-off of a qualified financial adviser to access high risk investments, unless they also be considered a "Sophisticated" investor. Their relative wealth should not make them prey for scammers just because they can afford to lose money, rather it should mean that they are guided to or even required to avail themselves of relevant professional advice before entering into a high risk investment; and
    - A "Sophisticated" investor should either:

        (i) already have a suitable qualification: CFA, ACCA, DIPFA, etc.; or
        (ii) have served as a board director of a company of a minimum size and for at least (say) 2 years;
        (iii) have completed a longer on-line exam provided by an independent and reputable provider (and not the product firm), which if successfully passed would award the client a certificate to cover them for a specific category of investments, e.g. EIS or structured products with auto-calls) for a period of a number of years; or

(iv) have a completed a shorter on-line exam again provided independently of the product firm but directly related to that investment for each individual investment.

- CFA UK notes that the last two options above are still potentially open to gaming (the provider gives the client the answers to "save them time") and so there should be some accompanying clear warnings about the risks of these investments as the consumer works their way through the on-line exam. There also may be practical problems in delivering and maintaining a sufficient number of such shorter exams given the wide array of high risk investments available, so perhaps this is only an option for certain and not all high risk investment products.

Q23: What do you think about the current high net worth and self-certificated sophisticated investor exemptions are working in practice and the level they are set at?

- CFA UK believes that whilst they are well intentioned, the definitions as set down in COBS 4.12.6 are in practice in need of updating and revision:

HIGH NET WORTH

- In our answer to question 19 we advocated that High Net Worth investors should be guided or even required to get the sign-off of a qualified financial adviser to access high risk investments.
- The existing wealth test is rightly set as a % of net investable wealth (not including main residence, insurance or pensions). However, rather than this self-certification being used as the threshold for an automatic ability to make high risk investments, we would suggest it should be used to distinguish between those who are guided to get a sign off from a qualified financial adviser and those who are required to.
- We would suggest that in circumstances where a consumer's total exposure to high risk investments moves above (say) 10% of their net investable wealth, the sign off of a financial adviser should be required and should thereafter be required at additional increments of 5%. Such a regime would ensure that a professional financial adviser considers not only the merits of each individual investment but also the cumulative effect of all of them on the consumer's overall financial position;
- In the same way that the wealth test is netted against housing, insurance and pension wealth, we believe the salary test should also be struck after overheads. In this context, the current gross salary threshold of £100,000 is quite low and a consumer could easily have most or all of this spoken for in fixed outgoings such as tax, NI, mortgage payments, utilities, other debt

service and non-discretionary expenditures. In other words, we believe the FCA should restructure this test to be a discretionary/disposable income test;

- Again, rather than this self-certification being used as the threshold for an automatic ability to make high risk investments, we would suggest it should be used to distinguish between those who are guided to get a sign off from a qualified financial adviser and those who are required to. Certainly, a consumer who has no net investable wealth, has a salary above £100,000 and wishes to invest more than 100% of their discretionary/disposable income in a high risk investment, really should be getting professional, independent financial advice.

<u>SELF-CERTIFIED SOPHISTICATED</u>

- The existing self-certified sophistication test is in reality far too easy to satisfy. One high risk investment cannot make a consumer 'sophisticated', especially now that, as the paper points out, crowd-funding platforms have made such investments so readily accessible.
- We refer to our answer to Question 19 for suggested terms by which consumers might be able to self-certify themselves as "sophisticated" and underline the role of both education and practical experience in this.
- It is probably appropriate for the FCA to sub-divide the high risk investments market and have different requirements for different types of investment. For example, the 2 years of board director experience may not help an individual understand the risks on a structured product with auto-calls, hedge funds or in leveraged options but it would help them understand an EIS investment.
- We disagree with the current rule that 6-months membership of a business angel syndicate automatically permits an individual to self-certify as a sophisticated investor. This is not so say that relevant and sufficient experience could not be gained in this way, but we suggest it would depend heavily on the syndicate itself and also the level of involvement the individual had with the syndicate during those 6-months. Registration with a crowd-funding web-site without further additional involvement would clearly not be adequate, for example, and yet might be seen as evidence of meeting the current test.