Broadening access to financial advice for mainstream investments

BSA response to CP22/24

Restricted

Building Societies Association

Summary

The Building Societies Association (BSA) represents all the UK's 43 building societies and seven of its larger credit unions. Building societies serve almost 26 million consumers across the UK and have total assets of nearly £500 billion. They hold over £342 billion of retail savings, accounting for 18% of all cash savings in the UK. With all of their headquarters located outside London, building societies employ more than 51,500 full and part-time staff. In addition to digital services they operate approximately 1,300 branches, making up a rising share of financial services branches in local communities.

BSA response to FCA CP22/24

- The BSA supports the broad aim of the FCA's Consumer Investment Strategy for a consumer investment market in which consumers can invest with confidence, understanding the risks they are taking and the regulatory protections provided.
- We understand the desire to support mass-market consumers who may benefit from investing through enabling simplified advice. As part of the safeguards around this, we support limiting the range of investments under simplified advice, and can see that using framework of existing Stocks & Shares (S&S) ISA regime makes sense, as well as the various other limits and restrictions. However we believe the £10,000 threshold is arbitrary and too low a limit. To date there has been little justification for this level, but it is fundamental to the proposals so it is vital that it is calibrated appropriately.
- It is sensible for all consumers to think about how they will achieve their financial objectives, but it is important that they do this with an understanding of the risks that achieving those objectives might entail for them. We want to make sure that individual consumers' risk appetites and preferences are sufficiently protected in the core investment advice regime.
- We suggest some additions to the guidance to ensure that an individual's risk appetite, medium term savings objectives, and existing ISA subscriptions are given due consideration to help to ensure that consumers do not end up being harmed by making decisions or taking risks if they did not fully comprehend the consequences of these decisions.
- Separately, we highlight a potential impact of the proposal, and which is not included in the Cost Benefit Analysis, on deposit-takers which, other things being equal, will have to raise the funds that are withdrawn to invest in S&S ISAs from other sources. This could have knock-on implications in other markets.

General comments

Before answering the questions in the CP, a more general comment is that the CP looks at the investment market in isolation, and does not consider the consequences on other markets, notably the impact on the cash savings market. For example, the cost-benefit-analysis does not include the potential knock-on impact on deposit-taking firms if investors withdraw their savings from cash savings accounts in volume.

If the FCA's target of 840,000[1] consumers reduce their cash savings by the end of 2025 this could lead to deposit taking firms needing to replace these funds or find alternatives. If we assume that the full £20,000 investment under the Core Investment Advice is invested, this amounts to £16.8 billion across these consumers.

Based on Bank of England data there was an average monthly increase in households' cash savings balances of £4.3 billion (for the three years 2017-2019, prior to distortions due to the Covid pandemic). If this trend resumes we might expect cash savings balances to increase by approximately £91 billion from April 2024, when the Core Advice regime is intended to be introduced, to the end of 2025, as per the FCA's target.

If £16.8billion is withdrawn to be invested in S&S ISAs via the Core Investment Advice regime, this would be equivalent to about 18% of this expected increase in balances over this period. To maintain their business objectives deposit takers would have to find alternative sources of funds, perhaps paying higher interest rates on retail or wholesale funding, and may look to offset these increased costs elsewhere, such as in higher loan rates.

However, if these withdrawals are front-loaded to when the core advice regime is introduced from April 2024, this could increase pressures at this time. As a result, interest rates in retail and wholesale funding markets could be bid up further in these early months in particular.

We urge the FCA to consider the wider impacts of this policy on other markets, and consider whether the 2025 target date is strictly necessary.

Responses to selected questions in the CP

We do not have a view on many of the questions in the consultation paper (CP) as the majority of our members are not likely to provide core investment advice themselves. We therefore focused our responses to selected questions below where we have a view.

[1] 20% of the 4.2 million savers with more than £10k in cash and who have suitable risk appetite.

Q1: Do you agree with our proposed defining features of core investment advice? Please explain your answer and suggest alternative approaches if you believe these could achieve the same objective.

In order to simplify advice so that it is more cost effective to provide, it is appropriate that there are safeguards in place around the proposed regime. We therefore support the definition of core investment advice in paragraph 3.4, including limiting advice to new S&S ISA investments up to the £20,000 ISA threshold and, within this, on a limited sub-set of investment products.

However we do not think that the £10,000 threshold for an individual's existing cash savings has been sufficiently justified to date. We believe the threshold is likely to be too low and should be reviewed before the reforms are introduced.

In the cost benefit analysis in the CP the £10,000 threshold is defined as "a proxy for what 'holding too much cash' looks like in practice" (CP, Annex 2 para 3 pg 60). We do not believe that this has been evidenced anywhere. As far as we can tell, the £10,000 threshold that forms the basis of these recommendations comes from 2017 data, and was fairly arbitrary. It should at least be more robustly tested and justified. The 2017 FAMR Review stated that "While there is no definitive threshold of the level of investable assets at which financial advice should be sought, we consider £10,000 to be a reasonable proxy for our research." No further justification is given.

There is a footnote on the £10,000 threshold the FAMR Review which states that the median income at the time (£26,300 in 2015/16) meant that the broad rule-of-thumb of holding the equivalent of three month's expenditure in an instant access savings account amounted to around £5,000. The implication is that the remaining £5,000 up to the £10,000 threshold could satisfy other motivations for cash savings. Again this is not substantiated or detailed in the FAMR Review. ONS has since revised up the 2015/16 data, and the latest available data show that median household disposable income had risen to £31,400 by 2020/21, meaning that three month's spending, if all income was spent, is now closer £7,900 leaving just £2,100 in other cash savings before the £10,000 threshold is reached. This is significantly lower than when the £10,000 threshold was first proposed.

Consumers will have various valid savings objectives beyond an emergency buffer, but which do not count as long-term (defined as five years or more under the core investment advice proposals) investments, and capacity needs to be given for these. We discuss this in more detail below in response to Q7 on the suitability requirements. For some people £10k or more in cash will be appropriate as part of a balanced portfolio. The FCA should also give more justification why five years is the appropriate time to count as a long-term investment horizon.

Q2-Q4: Not answered

Q5: Do you agree with the proposed approach to service design and filtering? Please explain your answer and suggest alternative approaches if you believe these could achieve the same objective.

As set out above, we believe the £10,000 cash savings threshold used in the Strategy is arbitrary and too low, and is not appropriate for distinguishing individuals with "surplus savings", as they are referred to in the CP. As such we do not agree with the proposed approach to defining the target market.

The calibration of the threshold has important implications, including for the marketing of core investment advice as the threshold is likely to set the baseline for providers when they come to identify their own target markets.

Q6: Not answered

Q7: Do you agree with our proposed approach for the factors that we consider are relevant for obtaining the necessary information on a client's financial situation?

Please elaborate on the reasons for your answer, as well as outlining where applicable any alternative approaches that you would suggest.

It makes sense that all consumers think about how to achieve their own financial objectives, but it is important that they do this with an understanding of the risks that achieving those objectives might entail for them.

We suggest two areas where the guidance could be strengthened to help achieve this:

1. Medium term savings objectives

There is an implicit assumption in the paper that the motives for saving are either for an emergency buffer, or for long-term returns (defined in the regime as 5 years or longer).

It is important that suitability considers the individual potential investor's motives and objectives for saving investing, as set out in the CP.

There is a suitability requirement that the client holds sufficient liquid assets that would cover any unforeseen emergency capital expenditure (suggesting 3-6months' usual outgoings). We believe that the provider should be expected to do more to assess whether the client would also continue to hold sufficient other cash savings above this emergency amount to reasonably meet their medium term (under 5 years) financial objectives. The CP does say there is an expectation that a firm would satisfy itself that the client does not have any significant envisaged or foreseen capital expenditure over the likely term of the investment, but this is potentially too narrow, as a consumer's savings objectives in the medium term may not be for specific, foreseen expenses. Without a more explicit consideration, the requirements cover emergency savings and then jump to long-term investment objectives. The risk is that savings objectives in the 2-5 year horizon get inadvertently squeezed, so that in practice a substantial number of investors have to access their S&S investments before the intended minimum 5 year investment period.

2. Attitudes to risk

The FCA says that "A key part of the Consumer Investment Strategy is addressing harm to mass-market consumers who may benefit from investing in line with their risk appetite, but who currently hold their savings in cash." (Paragraph 1.2 of the CP.) It is crucial that the core investment advice regime enables consumers to invest in line with their risk appetite but does not go beyond this.

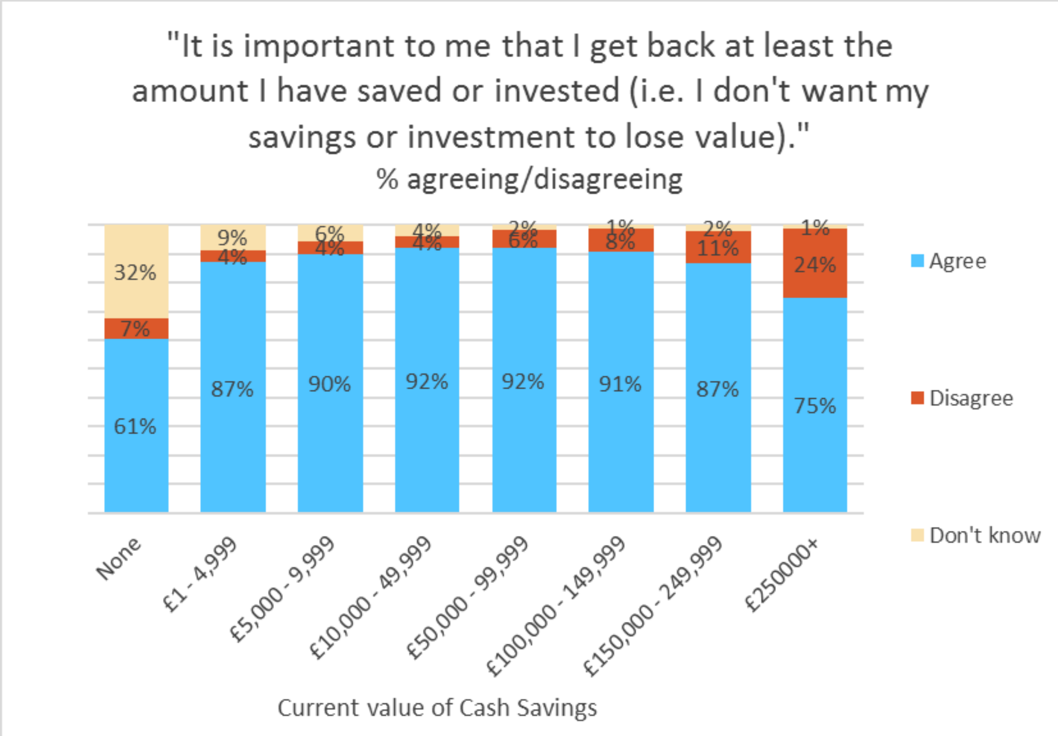
Recent survey evidence we commissioned from YouGov shows around 90% of people agree that it is important that they get back at least the amount they have saved or invested, presumably in nominal terms at least, demonstrating that many potential investors are risk averse. This applies even for those with savings much greater than £10k, as shown in the chart on the next page.[2] Research by Oxera for TISA also found that the main barrier to investing in S&S ISAs appears to be the perceived riskiness of S&S.[3]

While there is certainly a case for educating and informing consumers about the true nature and extent of the risks to different investments[4], including cash savings, the core investment advice regime must not incentivise or pressure consumers into taking on a greater amount of risk than they are comfortable with, and the guidance should reinforce this.

[2] YouGov for the BSA. 2,057 adults. Fieldwork was undertaken between 1st - 2nd December 2022. The survey was carried out online. The figures have been weighted and are representative of all GB adults (aged 18+).

[3] *The keys to unlocking greater investment in Stocks and Shares ISAs*, Oxera, November 2022 https://www.tisa.uk.com/wp-content/uploads/2022/11/FINAL-OXERA-REPORT-FOR-PUBLICATION.pdf

[4] There is a case for improving financial capability more generally, and many building societies conduct a range of financial education activities to advance this: for more see this BSA report



Q8: Not answered

Q9: Do you have any comments on the content in the non-Handbook suitability guidance? Please provide supporting information in explaining your answer and if there is anything additional that you consider should be included.

It is important that the interactions with existing ISA holdings, and in particular, current year subscriptions, are explored with the potential investor. This should be explicitly covered in the non-Handbook guidance. For example, the provider should seek to understand any other subscriptions made to Cash, S&S or other ISAs in the current tax year that could reduce the amount that could be invested to stay within the £20,000 threshold. In addition, the provider should seek to ensure the consumer understands that they will not be able to make any other subscriptions to any ISAs for the remainder of that tax year. The consequences with HMRC of over-subscribing should be explained to the investor.

As described in our answer to Q7, the provider should be required to consider medium term savings objectives as well as emergency savings and long term objectives.

Q10-35: Not answered

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The Building Societies Association (BSA) is the voice of the UK's building societies and also represents a number of credit unions.

We fulfil two key roles. We provide our members with information to help them run their businesses. We also represent their interests to audiences including the Financial Conduct Authority, Prudential Regulation Authority and other regulators, the Government and Parliament, the Bank of England, the media and other opinion formers, and the general public.

Our members have total assets of almost £500 billion, and account for 23% of the UK mortgage market and 18% of the UK savings market.