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By email: cp21-23@fca.org.uk

Dear Sir / Madam,

Financial Services Consumer Panel response to CP21/23 PRIIPs – Proposed scope rules and amendments to Regulatory Technical Standards.

The Financial Services Consumer Panel (the Panel) is an independent statutory body. We represent the interests of individual and small business consumers in the development of policy and regulation of financial services in the UK.

We welcome the opportunity to respond to this consultation to improve the regulation of Packaged Retail and Insurance-Based Investment Products (PRIIPs).

We consider it important that the overarching regulatory regime governing retail investments, including PRIIPs, provides a coherent approach to setting regulation that meets consumers' needs. We do not feel that investing is right for all consumers, but for those who do choose to engage in the market, we set out our vision for how the market should function in our [response to the FCA's call for input on consumer investments](#)¹.

The foundation of this vision is firms having a duty to act in the best interests of their customers. This would make the firm responsible for the appropriate distribution of high-risk investments including the marketing, labelling and comparability of different investment options, as well as consumers' overall suitability for and understanding of the products which they invest in. This would create a market where:

- more of the population with investible assets, and where the decision is right for them, make an active and informed choice to invest, so maximising their own returns and supporting the real economy;
- the information disclosed to potential investors is designed in a way that will allow them to make effective decisions, and to compare the risks and rewards not only of different options for a given product type, but also of different products;
- it is not possible to use regulatory arbitrage to circumvent rules designed to protect consumers;
- there is a common industry-wide definition of consumer segments which is used to inform product design, set purchasing channels, target marketing and ongoing engagement. The Panel believe that there should be more common definitions for each type of consumer, there are many more segments than 'high net worth', 'novice' or 'able to sustain losses';
- the use of client self-certification must cease;
- information, education, guidance and advice is readily available and tailored to the consumer to ensure they are supported in taking decisions both pre-investment and on an ongoing basis. This will require the re-engineering of current thinking to better integrate these aspects together and blend them throughout the customer's

¹ https://www.fs-cp.org.uk/sites/default/files/final_fscp_response_consumer_investments_call_for_input_20201215.pdf

investment life-cycle. Only in this way will trust be established and consumers supported through what is an inherently complex set of decisions;

- the use of guidance or advice should be the gateway to anything other than a range of default-based, simple, tax-efficient investments;
- products must be better designed, labelled and described to enable consumers to better understand fully the opportunities, risks and costs involved and easily compare these across options; and
- when harm does occur, there must be easily accessible and efficient redress and compensation solutions.

The Consumer Panel welcomes the FCA's decision to make adjustments to the regulations governing PRIIPs in cases where there are clear signs that they might result in consumers being misled. As identified in the consultation, both providers and advisors have an obligation for communication with consumers to be fair, clear and not misleading and the Panel supports this obligation. Given the evidence that the FCA has gathered, it is clear that in some cases there is a potential conflict between existing PRIIPs rules and this obligation. This means that it is important that this conflict is resolved and that the regulations are adjusted to make this possible and the Panel supports the FCA in this aim.

However, we are concerned about two aspects of the FCA's proposed approach:

1. Firstly, the Panel considers that it is important that any proposed changes should produce consistent outcomes to ensure that consumers can use the information they are provided with to compare products effectively. The changes that the FCA has proposed do not necessarily achieve this. For example, while the Panel supports a mechanism for adjusting the risk rating of Venture Capital Trusts (VCT) to reflect the riskiness of these vehicles better, it notes that the proposed mechanism will leave it open to VCT providers to decide on the final risk rating. As different providers may use different factors when making this decision, this may make it hard for consumers to rely on the resulting risk ratings to compare between VCTs.
2. Secondly the Panel notes that the FCA is only proposing to do consumer testing of options as part of its policy statement, in other words once many of the decisions have already been made. The Panel considers that consumer testing should have been done to inform this consultation, in order to properly understand the impact of the proposed changes to disclosure requirements on consumers' ability to make effective investment decisions. The FCA's decision to leave testing to a later stage in the policy setting process means that the implications for consumers will not have properly informed the proposed changes. For example, what impact will the proposed adoption of using a narrative description of performance have on consumer decision making?

Our responses to the questions posed in the consultation are included at Annex 1 below.

Yours sincerely,

Wanda Goldwag

Chair, Financial Services Consumer Panel

Annex 1

Question 1 Do you agree with our proposed rules to clarify the scope of the PRIIPs regime?

The FCA's proposals aim to clarify the distinction between PRIIP and non-PRIIP debt securities. The Panel understands why providing greater clarity might reassure issuers and improve liquidity in the market. However, the Panel notes that, even without this proposed change, the proposals discussed as part of Question 3 of this consultation would by themselves already provide sufficient clarity to allow any issuer to do so without providing a Key Information Document (KID), providing the issuer did not intend to issue debt to the retail market.

As such, the purpose of this clarification relates primarily to the FCA's aim set out in paragraph 2.17 of this consultation, namely giving "*issuers the confidence to broaden the availability of corporate bonds to retail investors*".

In relation to this aim, the Panel considers that the FCA has not made its case, and therefore we cannot support this proposal without additional evidence. The Panel considers that it is really important for disclosure requirements for different investment products sold to retail clients to be set in such a way that retail clients are able to make effective investment choices, not just within a particular product group but also between product groups. Without consumer testing of how effective decision making is when retail customers are asked to compare the disclosure for PRIIPs and for non-PRIIPs corporate bonds, it is not possible to determine whether this clarification might undermine effective decision making.

Question 2: Are there remaining areas of ambiguity in the scope of the PRIIPs Regulation which would not be addressed by the proposed rules, and if so, which?

No comment.

Question 3: Do you agree with the proposed guidance on conditions for a PRIIP to be regarded as not made available to retail investors?

The Panel recognises the importance of ensuring that regulation is proportionate. The Panel therefore supports the FCA's decision to seek to clarify under what circumstances a PRIIP might be deemed to have been "made available" to a retail client, and hence when it might require the production and publication of a KID.

The Panel also supports the specific proposals set out in this consultation, setting a minimum denomination size of £100,000 and a clear requirement that this product is only targeted at professional clients and eligible counterparties.

However, the Panel notes that the term "professional client" includes "elective professional clients". In the view of the Panel the definition of elective professional clients is currently sufficiently robust to ensure that only professionals are likely to qualify. However, if, in future, this definition were to be relaxed, the Panel considers that the FCA should then revisit whether it would remain appropriate to continue to allow some PRIIPs to be deemed not to have been made available to retail clients. This reflects the Panel's view that self-certification is inappropriate. For example, the Panel notes the example from the research undertaken by London Economics to inform HMT's recent consultation on Non Transferable Debt Securities, which found in Section 5.3.2 of the research that:

"A few received cold calls from finance company's [sic] trying to sell a mini bond to them. One spoke of receiving a follow-up call from the provider when the online application form said she wasn't eligible for the mini bond; the caller told her to complete the form again and answer in such ways [sic] as to ensure it accepted

her application. She has since lost £80,000 as the company went into administration."

Finally, the Panel notes that the wording on the minimum denomination set out in paragraph 2.22.c. of the consultation ("or under") contradicts the wording in Paragraph 2.3.1(3) of the draft Handbook Text and changes to RTS. For the avoidance of doubt, the Panel supports the latter.

Question 4: Do you agree with our proposal to remove the requirement for the KID to display performance scenarios?

The Panel notes the evidence that in some cases the existing methodology for producing performance scenarios might lead to misleading outcomes, because of the pro-cyclical nature of the methodology. Clearly this is undesirable.

However, before the Panel can endorse the FCA's proposal to remove performance scenarios from the KID, rather than amend the methodology, the Panel considers that it would be helpful to undertake consumer testing. Consumer testing would allow the FCA to understand what role (if any) performance scenarios play in consumer decision-making. If the existence of performance scenarios can be shown to have no (or negative) impact on decision-making, then dropping them from the KID is clearly appropriate.

If, however, performance scenarios have a positive effect on consumer decision-making, allowing consumers to make better investment choices, then the Panel considers that instead of dropping them it would be appropriate to look at ways to improve the methodology for calculating performance scenarios.

Question 5: Do you agree with our proposal to require PRIIP manufacturers to include a narrative description of performance in the KID?

The Panel notes that the FCA intends to undertake consumer testing of this option.

The Panel considers that it is not possible to endorse this proposal until the results of this consumer testing are known. The Panel considers that this consumer testing should also consider potential pictorial/graphical approaches to illustrating performance by way of comparison, and that the aim of the consumer testing should be to establish the impact of different options on decision-making, not just whether consumers "like" a particular option.

a) If so, should the FCA specify the factors that the narrative should cover (as applicable)?

Yes. It is important that disclosures are as comparable as possible, in order to help consumer decision making. However, it will also be important to test potential options to assess their impact on decision making, to ensure that consumers can use the KID to make effective decisions.

Question 6: Do you agree with our decision not to include past performance as part of our proposals for information on performance

The Panel considers that one of the goals of the regulation governing disclosure documents should be to allow consumers to make effective investment decisions, not just within a given product type, but also between alternative product options. The Panel notes that one of the reasons proposed for introducing past performance is that it would better align the PRIIPs' KID to the Key Investor Information Document (KIID) used by Undertakings for Collective Investment in Transferable Securities (UCITS). Despite this, the FCA is proposing not to include past performance.

The Panel considers that it would be appropriate to undertake consumer testing to determine whether the addition or omission of past performance might distort decision

making. Without appropriate testing, the Panel considers that it is not possible to endorse the FCA's proposal.

a) if not, can you please explain why you think the addition of past performance in the KID alongside a narrative description of performance would be useful to consumers and their investment decision making?

As set out above, the Panel considers that the decision to include or exclude past performance should be based on consumer testing of its impact on decision making.

Question 7: Do you agree with our proposal to require PRIIPs manufacturers to upgrade a product's SRI score where the score resulting from application of the RTS methodology seems to underestimate the level of risk?

In order to be an effective tool for decision making, it is important that the methodology for scoring products, for example as part of a risk indicator, should be applied consistently. Where decisions are discretionary, consumers may be misled in situations where Manufacturer A and Manufacturer B make different choices when scoring what are otherwise identical products.

For this reason the Panel considers that the introduction of discretion in relation to the risk scores associated with the KID for PRIIPs is suboptimal.

The Panel would instead urge the FCA to consider amendments to the underlying methodology that would deliver a better and more consistent approach to scoring.

The Panel considers that as part of this exercise the FCA should consider what factors will make a good risk score, so that alternative approaches can be judged against these criteria. For example, an important factor in determining whether a risk score methodology is effective, is likely to be how stable the resulting risk score is over time, so that products with a low risk ranking do not morph into high risk products and vice versa. Research in 2010 by Professor Andrew Clare demonstrated that this is most likely to be achieved where long runs (10 years) of data are used. This is because long runs of data are more likely to encompass a full business cycle, and hence are less likely to be distorted by picking a purely benign investment period. In contrast the Panel notes that the existing methodology for calculating market risk measure underpinning the Summary Risk Indicator (SRI) for PRIIPs can be based on as little as two years of data.

Question 8: Do you agree with our proposal that PRIIPs which are issued by venture capital trusts should be assigned a summary risk indicator of at least 6?

The Panel supports the aim of ensuring that the risks associated with Venture Capital Trusts (VCT) are properly understood by consumers and are not distorted as a result of a quirk in the methodology used to calculate the SRI for PRIIPs.

However, for the reasons set out in the Panel's answer to Question 7 of this consultation, the Panel considers that the best approach to addressing problems with the SRI would be to re-examine the methodology used to calculate it. Assigning VCTs a minimum risk indicator of 6 may address the worry that the score for VCTs is too low. However, for example, it leaves it to the discretion of the VCT as to whether a score of 6 and 7 is chosen, and is not based on any factual evidence to show that a score of 6 for VCTs is appropriate, when the risks of VCTs are compared to the other products with similar scores. For this reason the Panel considers that the FCA's proposed approach is suboptimal.

Question 9: Are there other PRIIPs in respect of which the FCA should specify the summary risk indicator? a) If so, please let us know which, with your reasons and any evidence you may have.

No comment.

Question 10: Do you agree with our proposal to increase the character limit for disclosures of uncaptured risk?

The Panel considers that it is really important that customers properly understand the risks associated with their investments. As such, the Panel supports extending the current 200-character limit for describing uncaptured risks to 400 characters. However, the Panel considers that it will be really important that any descriptions should be presented in non-technical language in a way that will help consumers, and therefore considers that the FCA should monitor the impact of this change on disclosures.

Question 11: Do you agree with technical amendments we are proposing to make to the PRIIPs RTS for transaction costs?

Overall the Panel supports the FCA's proposed approach to transaction costs. However, we also have some additional suggestions that we consider could potentially benefit consumers, and these are recorded in our responses to individual questions below.

Question 12: Do you agree with our proposed amendments in relation to anti-dilution?

The Panel agrees that the presentation of transaction costs should not show negative transaction costs. We also agree that the transaction costs associated with inflows or outflows from the fund (so called anti-dilution costs) should be treated separately to avoid cross-subsidies occurring between different fund investors (ongoing, new and exiting). This means that costs recovered to avoid anti-dilution should not be included in the calculation of ongoing running costs of the fund.

The FCA's evidence suggests that in some cases subtracting anti-dilution costs from normal costs can give the appearance that transaction costs as a whole are negative. Given this, the Panel supports the FCA's proposal that transaction costs associated with anti-dilution should only be taken into account to the extent that they do not take total transaction costs below zero.

However, where anti-dilution costs occur, the Panel considers that it would also be appropriate for the information on anti-dilution costs to be recorded separately in the KID, in order to allow investors to understand properly the costs associated with exiting the fund.

In addition, the Panel notes that the fact that in some cases subtracting anti-dilution costs from transaction costs as a whole would give rise to negative transaction costs is evidence of a cross subsidy. The Panel considers that this type of cross subsidy is inappropriate. We therefore suggest that the FCA works with firms to clarify that any cross-subsidy is inappropriate and to ensure that practices are adjusted to eliminate this.

Question 13: Do you agree with our proposed clarification in relation to OTC bond transactions?

Yes.

Question 14: Do you agree with our proposed shift to a spread model in calculating costs for index-tracking funds?

No comment.

Question 15: Do you agree with our proposal to clarify how to calculate the average price of transaction costs?

Yes. The Panel agrees that the calculation of transaction costs should be an average of all transaction costs over three years, not the average of three annual averages.

Question 16: Do you have any comments on our cost benefit analysis?

The Panel agrees with the FCA's assessment that taken as a whole the benefits of the changes proposed in this consultation are likely to exceed potential costs.

However, in several cases the Panel notes that the FCA has made proposals that go beyond simply clarifying the methodology that firms use and instead will change how the KID itself is presented. Although the FCA has proposed undertaking consumer testing for its proposals relating to performance narrative before it makes its policy statement, the Panel considers that it would have been more appropriate to undertake not only this testing, but testing of additional proposals, at an earlier stage, in order to inform this consultation. This would have allowed the FCA to properly consider the alternatives, by understanding the impact of potential options on consumer decision making.