Briefing

Funds and Financial Regulations

FAMR and automated advice

In August, HM Treasury and the Financial Conduct Authority ("**FCA**") jointly launched the Financial Advice Market Review ("**FAMR**"), with the aim of understanding how financial advice could work better for consumers.

The FCA Call for Input in respect of FAMR was then published in October, followed by the FCA Regulatory Sandbox report this month.

With this flurry of activity, the Call for Input response deadline on 22 December and the FCA hosting a Regulatory Sandbox stakeholder event in December (date to be confirmed), we recall the main facets of the FCA's publications.

FAMR - Scope of Review

FAMR has a wide scope to consider the financial services market and the availability of advice to people, particularly those who do not have significant wealth or income.

Due to this breadth, FAMR is relevant to financial advisers, asset managers in the retail fund sector and, in respect of automated advice, Fintech businesses. It considers:

- regulatory and other barriers firms may face in giving advice and how to overcome them
- how to give firms the regulatory clarity and create the right environment for them to innovate and grow
- the opportunities and challenges presented by new and emerging technologies to provide cost-effective, efficient and user-friendly advice services
- how to encourage a healthy demand side for financial advice, including addressing barriers which put consumers off seeking advice.

The FCA and HM Treasury intend to use the FAMR findings to support requests for changes to EU law to allow the UK advice market to function better, with final recommendations from FAMR are expected ahead of Budget 2016.

Call for Input and automated advice

Whilst stakeholder responses to the entire Call for Input should prove insightful, we are particularly interested in the questions concerned with respondents' experience of the provision of automated advice (commonly referred to as "robo-advice").

The development and availability of automated advice provides an excellent opportunity for the provision of lower cost, efficient and user-friendly advice to a wider market of investors who might not otherwise have the opportunity to engage in traditional advisory services.

Barriers to Entry

Whilst cost may be the key barrier to the availability of financial advice (beyond the narrow regulatory sense) for the mass retail market, the Call for Input also seeks to understand the extent to which automated advice is trusted by the clients its services are aimed at.

In addition to the FCA's attempts to understand the implications of automated advice for consumers, it also seeks input from potential product providers on the regulatory and commercial barriers to entry in the market. In our experience the key considerations for automated advisers when entering the market are (i) the cost of providing services in a low-margin market and (ii) the ongoing liability of financial advisers for the advice they provide.

For example, the current regime of direct and indirect regulatory costs imposed on authorised persons makes it more difficult for those businesses not only to be able to provide low-cost advice to the mass retail market, but to also remain both profitable and competitive.

Equally in an effort to protect consumers, a number of regulatory requirements are currently placed on advisers which we do not consider translate well to the automated advice market. The suitability requirements in COBS, for example, require financial advisers to gather much more data from a potential investor than we have seen providers of automated advice in other markets seek to obtain. Furthermore, the FCA will need to consider whether a requirement to provide a suitability report can be satisfied by text that is automatically generated based on the result of the advice algorithm.

These barriers to operation could be effectively removed if certain, limited, types of advice (for example, automated advice) were able to be given under a cut-back (and lower cost) regulatory regime. This could be achievable using a risk-based approach where, for instance, the algorithm used to provide advice is stress-tested and approved by the regulator, or in respect of transactions that are smaller than a stipulated initial or regular investment amount.

In this regard the FCA's proposal for a Regulatory Sandbox, which is to be implemented as part of Project Innovate, is helpful. If properly worked through it could provide a safe platform for robo-advisers to test their advice offering within a regulation-lite arena, and with a number of initial safeguards in place (for example having financial advisers checking advice before execution).

We also consider that suitability obligations could be scaled back where the scope of automated advice is limited to particular investments and/or where suitability reports and set up as templates to be populated by standard wording, agreed in advance with the FCA.

The FCA's initiatives to address regulatory gaps through stakeholder engagement are promising for existing businesses and new entrants seeking to provide automated advice and we look forward to industry engagement with the Call for Input and the Regulatory Sandbox event.

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