Title: Amending the UK definition of investment advice **IA Number:** RPC17-3656(1)-HMT **Lead department or agency:** HM Treasury **Other departments or agencies:** N/A	**Impact Assessment (IA)** **Date: 02/02/2017** **Stage:** Final **Source of intervention:** Domestic **Type of measure:** Secondary legislation **Contact for enquiries:** Megan Blade Megan.Blade@HMTreasury.gsi.gov.uk 02072704879

Summary: Intervention and Options

RPC Opinion: Green

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2009 prices)	**In scope of One-In, Two-Out?**	**Measure qualifies as**
+£4,151.6m	**+£4,151.6m**	**£415.14** (net benefit)	Yes	OUT

What is the problem under consideration? Why is government intervention necessary?

The Regulated Activities Order (RAO) defines investment advice more widely than the Market in Financial Instruments Directive (MiFID). The wider UK definition means firms are unclear about the boundary between regulated advice and guidance. As a result, they are only adopting basic guidance services, increasing the risk of consumers making poor investment decisions on their own. We are therefore proposing to change the RAO definition to reflect the definition used in MiFID, for regulated firms only. The MIFID definition (based on a personal recommendation) is clearer and easier for firms to build into their compliance processes, and will allow regulated firms to provide more detailed guidance services. Unregulated firms remain subject to the RAO definition, protecting consumers from fraudsters who might try to use 'guidance' to sell consumers risky investments.

What are the policy objectives and the intended effects?

The government wants to ensure that firms have the confidence to deliver guidance services that can help to support consumers in making their own decisions about the right financial products for their needs and circumstances, and wants to ensure that the regulatory framework does not inhibit this. The change will allow firms to provide more useful information to support customer decision-making, such as the merits of, and the risks associated with buying and selling particular investments. Only making the change for regulated firms will prevent consumers being exposed to increased risk of being scammed.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

The government has considered the following options:

- Option 0 – maintain the existing regulatory framework; and
- Option 1 – replace the RAO definition of investment advice with that in MiFID for regulated firms.

The government's preferred option is Option 1. This will provide firms with a clear boundary between regulated advice and guidance to enable them to provide helpful support to aid consumer decision-making and supporting better consumer outcomes.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** 2019

Does implementation go beyond minimum EU requirements?			No		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** Yes	**< 20** Yes	**Small** Yes	**Medium** Yes	**Large** Yes
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** 0	**Non-traded:** 0	

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister: ______________ Date: 21/02/2017

Summary: Analysis & Evidence

Policy Option 1

Description: Replace the definition of financial advice currently under the Financial Service and Markets Act (Regulated Activities) Order 2000 with the definition used in the Markets in Financial Instruments Directive for regulated firms.

FULL ECONOMIC ASSESSMENT

Price Base Year 2017	PV Base Year 2017	Time Period Years 10	Net Benefit (Present Value (PV)) (£m) (Over 10 years)		
			Low: £218.1m	**High:** £15,4498m	**Best Estimate:** £4,151.6m

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	£7.7		£0	**£7.7m**
High	£50.6m	1	£0	**£50.6m**
Best Estimate	£28.6m		0	**£28.6m**

Description and scale of key monetised costs by 'main affected groups'

Firms will face only small familiarisation costs, including:

- A review by a firms' compliance team or by an external compliance expert.
- Small changes to documentations and websites that contain disclosures, or guidance to staff.

These costs were estimated by firms to be between £600-700 and £4,100 (for firms that serve large numbers of customers). These costs will apply only in year 1.

Other key non-monetised costs by 'main affected groups'

No non monetised costs are expected.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	£26.9m		£26.9m	**£268.7m**
High	£1,545.7m	1	£1.545.7m	**£15,456m**
Best Estimate	£418m		£418m	**£4,180.2**

Description and scale of key monetised benefits by 'main affected groups'

Firms are estimated to benefit from reduced compliance spend. Reductions in spending are expected to result from:

- A reduction in time spent monitoring staff communications with customers or other communications with retail customers. We have estimated savings of £64,125 per firm.
- A reduction in external spend on legal and compliance experts. We have estimated savings of £5,000 per firm.

Other key non-monetised benefits by 'main affected groups'

There are expected to be significant non-monetised benefits to both firms and consumers. Consumers will receive more guidance from firms, meaning they are more likely to choose financial products that are appropriate to them, and more likely to have the confidence to invest in financial products overall. Firms will benefit from being able to provide more guidance to consumers; consumers are more likely to feel that they have received good customer service if they are provided with high quality guidance, leading to higher customer retention. Consumers are also more likely to purchase products from firms that provide guidance, as they will have more confidence in their product selection.

Key assumptions/sensitivities/risks

- That this is a permissive measure. This has been confirmed by firms.
- That the relevant population of firms is made up of banks, building societies, life insurers, general insurance intermediaries and personal investment firms (which include financial advisers).
- That only a certain percentage of firms will receive monetary benefits, due to higher levels of risk aversion amongst some firms. A sensitivity analysis has been conducted (see Table 6).

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs: £2.86m	**Benefits:£418m**	**Net: £415.14**	YES	OUT

Evidence Base (for summary sheets)

Introduction

1. In August 2015, the government launched the Financial Advice Market Review (FAMR) to explore how financial advice could work better for consumers. FAMR was a joint review between HM Treasury and the FCA. It was co-chaired by Charles Roxburgh, Director General of Financial Services at HM Treasury and Tracey McDermott, Acting Chief Executive of the Financial Conduct Authority (FCA).
2. FAMR considered the regulatory and legal framework governing the provision of financial advice and guidance to consumers and its effectiveness in ensuring that all consumers have access to the help they need to make effective decisions about their finances.
3. FAMR revealed that there is an advice gap for consumers who have limited amounts to invest, as well as those who require specific support at retirement. It concluded that there is a clear need for intervention by the regulator and the government to help both consumers and industry benefit from new and more cost-effective ways of delivering high quality advice and guidance.
4. The review recommended a package of reforms to provide consumers with affordable and accessible financial advice, at all stages of their lives. These recommendations focussed on three key areas; the supply of advice and the cost firms face, consumers demand for advice, and how advisers are held liable for bad advice given in the past.
5. The FAMR final report was published on 14 March 2016 and the government welcomed the recommendations and committed at Budget 2016 to implement all of the review's recommendations for which it is responsible.
6. One of the recommendations was that the government should consult on amending the definition of regulated advice in the existing Regulated Activities Order (RAO) in line with the EU definition set out in the Markets in Financial instruments Directive (MiFID). The review suggested that this change will allow firms to provide more useful guidance to support customer decision-making, reducing the risk of consumers making poor investment decisions on their own. The next section discusses the issue in more detail.

The policy issue and rationale for government intervention

7. In general terms, 'financial advice' is a regulated activity. Other forms of help provided to consumers, often described as 'financial guidance' are not regulated by the FCA. This impact Assessment uses 'advice' as a shorthand for regulated financial advice. Other forms of help, which do not meet this definition, are referred to as 'guidance'.
8. There are some consumers whose straightforward needs or lower amounts to invest mean the cost of regulated advice may outweigh the benefits, while some firms may find it uneconomic to provide these consumers with this type of advice. Furthermore, FAMR found a growing trend towards consumers making and executing their own financial decisions.
9. These consumers would benefit from better and more personalised guidance services. However, a major theme highlighted during the review was a reluctance on the part of firms to offer other, potentially less expensive, support to consumers in the form of helpful guidance, for fear of straying into the provision of advice. Firms, consumer groups and employers raised concerns about a lack of clarity regarding the point at which more general forms of consumer support become regulated advice, suggesting that this limits their ability to help consumers. In particular, stakeholders highlighted the risks of the different regulatory requirements that apply depending on whether a firm is providing factual information on particular investments, or moving beyond that into advice on the merits and risks associated with buying or selling particular investments (i.e. non-personalised regulated advice).

10. In large part these concerns sprang from the unclear way regulated advice is defined in the Regulated Activities Order (RAO). The RAO is secondary legislation made under the Financial Services and Markets Act (FSMA) that establishes the regulatory perimeter for the FCA.

11. This uncertainty means that firms are not providing help to consumers in situations where they would wish to do so. Firms have suggested that, when considering how best to support consumers in making an informed decision, they are inhibited by aspects of the existing regulatory framework which prevent them from providing helpful support to aid consumer decision-making and supporting better consumer outcomes.

12. As a result of these concerns, a number of stakeholders have said that they have designed their current guidance services to stop a 'safe distance' short of where they perceive the regulated advice boundary to be. Firms also suggest that uncertainty on the position of the boundary causes concern about how the FCA and the Financial Ombudsman Service might interpret their actions in the future, giving rise to the risk of potential long-term redress liabilities as a result of inadvertently straying into the provision of regulated advice without meeting all of the regulatory requirements for doing so. In choosing to manage this risk by stepping back from the regulated advice boundary, firms are providing less support to consumers increasing the risk that they make poor investment decisions.

13. There was a broad consensus in the responses to the FAMR consultation that a clearer boundary between services that constitute regulated advice and those that constitute guidance would allow firms to provide the maximum amount of support possible to consumers making their own investment decisions. This would result in better outcomes for consumers.

14. FAMR stated that a key step to achieving clarity is amending the definition of advice in the RAO in line with that of the MiFID. The definition in article 53 of the RAO is broader and less specific than the definition used in MiFID, which is based upon a firm giving a customer a personal recommendation. Firms suggested that the EU definition based on a personal recommendation is clearer and much easier for them to build into their compliance processes. The current RAO definition 'advising on investments' is more subjective and has proved very difficult for firms to implement as it depends on a subjective judgement about what constitutes advice.

15. FAMR suggested that this proposal will allow firms to provide more useful information to support customer decision-making, such as the merits of, and the risks associated in general with, buying and selling particular investments. For example, firms suggest they would be willing to provide more detailed information in product disclosure documents and on their websites on the types of customer for whom their range of retirement income products are likely to be appropriate or inappropriate, or provide information on the risk profile of the funds available within their stocks and shares ISA. This could benefit consumers who want or need help to make their own decisions, and for whom advice might not be the right solution.

16. Stakeholders suggest this change will also provide greater certainty by: creating a single definition for regulated advice based upon the MiFID definition of a personal recommendation; removing some of the regulatory barriers constraining the content of current guidance services; and bringing the UK's definition of advice into line with that of other countries covered by MiFID. The government agrees with FAMR that firms should be able to deliver guidance services that can help to support consumers in making their own decisions about the right products for their needs and circumstances, and wants to ensure that the regulatory framework does not inhibit this. As a regulatory change is required to provide this clarity, there is a clear case for government intervention.

The Outcome of the Consultation

17. The government consulted on amending the definition of regulated advice to bring it in line with MiFID on 20 September 2016. The consultation ran for 8 weeks and received 63 responses.

18. The consultation set out the government's proposal to amend the definition of regulated advice in Article 53 of the existing Financial Services and Markets Act 2000 (Regulated Activities Order 2001) to bring it in line with the EU definition set out in MIFID. This would mean that only advice which makes a personal recommendation would be regulated.

19. In the consultation, the government set out a number of potential risks posed by moving the regulatory boundary. A significant number of respondents expressed concerns that using a narrower definition could allow fraudsters to operate in the guidance space. Specifically, they were concerned that unregulated firms would attempt to deliver 'advice' that stops short of a personal recommendation, but nevertheless is intended to persuade an individual to purchase risky investment products. The FCA may not then be able to take action against these fraudsters, as they are unable to take enforcement action in relation to activities that they do not regulate.

20. Therefore, the government will change the definition of financial advice for regulated firms only. Regulated firms will only be giving advice if they give a personal recommendation. The government will leave the wider RAO definition of advice as 'advising on investments' in place for unregulated firms only. This means that unregulated firms, some of whom may be fraudsters, will not be able to provide detailed and tailored guidance services without being in scope of FCA enforcement action. This will act as a shield to mitigate the risk of consumers being scammed.

Policy objectives

21. The government wants to ensure that people have access to the financial advice and guidance they need to help them make informed financial decisions. That is why it launched the FAMR to explore how financial advice could work better for consumers.
22. It is clear from the review that many customers do not want financial advice either because they cannot afford it or are not willing to pay for it, or because they would prefer to make their own investment decisions. Both of these groups of people would benefit from good financial guidance to help them make informed financial decisions at a more reasonable price. However, the unclear regulatory parameters currently in place mean firms are only providing simple financial guidance to these individuals. The objective of this regulatory change is to give firms the confidence to develop suitable guidance services to meet a range of consumer needs.
23. The proposed regulation maintains the original definition of advice as 'advising on investments' for unregulated firms. This ensures that consumers will not be exposed to greater risk of being scammed.

Policy options considered

i) *Option 0:* Baseline scenario – Do nothing

24. In the baseline scenario the government would take no action. The baseline is used to measure the costs and benefits of taking the action described in the government's preferred option (option 1). The costs and benefits of the option to take no action are zero as nothing will change.

25. Under the current regulatory framework, firms are not providing consumers with the level of guidance which consumers expect for the reasons set out in section 2. This is increasing the risk that consumers make poor investment decisions without support. The government does not want this situation to continue so believes that maintaining the status-quo is unacceptable. Following a comprehensive review in the financial advice market, FAMR recommended a clear need for intervention by the government to help both consumers and industry benefit from high quality financial guidance. This option has therefore been rejected on this basis.

ii) *Option 1 – Preferred measure*

26. This option would involve a change to the definition of financial advice in Article 53 of the RAO for regulated firms. The government will exempt regulated firms from requiring authorisation to carry out activities under Article 53 of the RAO, except where they are making a personal recommendation. The effect of this change will be that regulated firms only give advice when they are providing a personal recommendation to a customer. Unregulated firms will remain subject to the definition of advice as 'advising on investments'. The FCA would also amend its permissions regime alongside this regulatory change, to ensure that only those firms providing personal recommendations require permission to carry on regulated activities.

Expected level of business impact

Option 1- Preferred measure

Direct Monetised Costs:

27. Direct costs will apply only to firms who have communications with retail investors, whether in person, over the phone, through the internet or indirectly through advertising and other publications. 'Retail Investors' includes retail customers who purchase, or are looking to purchase financial products as set out in the RAO. This is because advice is only regulated if it is given to retail investors. Therefore, firms who do not have dealings with retail investors do not need to ensure that they are not giving advice.

Using firm data from the FCA we have estimated this population to be 12,335 firms. Firms falling into this category are banks, building societies, life insurers, general insurance intermediaries and personal investment firms (which include financial advisers). Two sub groups of this population need to be considered separately for the purposes of this Impact Assessment.

Firms not currently providing personal recommendations

28. Firms in this category distribute products or services to their clients without offering full regulated advice (or only offering full regulated advice through a separate advice arm). They rely on guidance services to support the provision of their products. There are approximately 8,023 firms that fall into this category. We have arrived at this figure by taking the total population, and subtracting the number firms whose main activity is retail investment mediation.

29. These firms ensure they comply with regulation by putting checks in place to avoid 'advising on investments', which they may not be authorised to do, or may not be meeting the regulatory standards for. After the change in definition, if the firm does not wish to change their business model to offer more guidance to their customers then they will not incur any costs, other than familiarisation costs. This is because, if their activities do not currently cross into 'advising on investments', those activities do not cross into giving personal recommendations either; 'advising on investments' is

broader than ‘giving a personal recommendation’. They will already be compliant with the narrower boundary of advice without making any changes to their operations.

30. This has been confirmed both through consultation responses and our conversations with affected firms.

Firms currently providing personal recommendations

31. The FCA estimates there are 4312 firms whose main activity is retail investment mediation. We have assumed that these firms are currently providing advice in the form of personal recommendations. This assumption is based on the fact that the FCA data showed all these firms have at least 1 financial adviser. This population is made up mostly of small and medium firms. Of these firms, only 22 have more than 50 advisers. 3907 out of the 4312 advice firms have under 5 financial advisers. [FCA Data Bulletin Issue 7- October 2016]

32. Firms whose main activity is providing personal recommendations will not incur any significant costs. As they offer full regulated advice as defined in MiFID, they will not be affected by the removal of the definition of advice as ‘advising on investments’. They will already be conducting their activities in accordance with the MiFID definition of advice as a personal recommendation.

33. This was also confirmed through consultation responses and our conversations with affected firms.

Estimated Costs

34. Firms will incur some familiarisation costs in year 1. Firms told us that familiarising themselves with the change would require:

    - a review by the firm’s compliance team or an external compliance expert. Firms estimated this would cost between £124 and £600.
    - small wording changes to documentation. Firms estimated this would cost between £500 and £4,000.

    The calculations used to arrive at our estimates are shown in Table 1. These figures represent the familiarisation costs to firms in year 1. Grey boxes represent assumptions made.

Table 1:

Review by compliance expert	Low Estimate	High Estimate	Best Estimate
Number of Hours:	2	4	3
Hourly Rate:	£62	£150	£106
Cost per Firm	£124.00	£600.00	£318.00
Overall Cost	£1,529,540.00	£7,401,000.00	£3,922,530.00

Documentation changes:	Low Estimate	High Estimate	Best Estimate
Cost per firm	£500	£3,500	£2,000
Overall Cost	£6,167,500.00	£43,172,500	£24,670,000.00

35. Due to the limited amount of data available, we have provided a range of figures based on the upper and lower estimates provided to us by firms. The high and low estimates are based on the highest and lowest estimates given to us by firms. The best estimate is the middle point between the two estimates.

36. We have assumed that these figures will not vary significantly based on firm size. This is because the costs of a regulatory assessment and adjustments to standard templates do not necessarily increase

proportionally to firm size. Additionally, the estimates firms provided did not vary significantly based on their size.

37. It is worth noting that the high estimate is very unlikely to be realised. This is because the high estimate for per firm costs relates to a firm that operates an expensive consumer facing website and large customer call centre operation. This is not representative of all firms in the market.

38. This results in total costs to firms and overall as shown in Table 2.

Table 2:

	Low Estimate	High Estimate	Best Estimate
Total Cost per Firm	£624.00	£4,100.00	£2,318.00
Total Overall Cost	£7,697,040.00	£50,573,500.00	£28,592,530.00

Possible Further Costs (Voluntary)

39. We expect that a significant number of firms who are not currently providing personal recommendations will want to take advantage of the new flexibilities. Firms who choose to alter their business models to provide more guidance to their customers will incur costs. These could range from small costs associated with training call handlers or in branch staff to provide more tailored information to consumers to larger costs incurred developing digital guidance tools to be hosted on the firm's website.

40. As this is an enabling measure, it can be assumed that firms will only adapt their business models to provide more guidance if the benefits outweigh the costs. For reasons that will be discussed, the benefits to firms of providing more guidance to their customers cannot be monetised. However, it is reasonable to assume that if a firm opts to provide more guidance to consumers, the benefits of doing so will be at least equal to the costs. Therefore, we have scored any possible further costs resulting from a change to business model as having a net impact of zero.

41. Firms who currently specialise in providing personal recommendations are unlikely to adapt their business models. Many consider themselves to offer a premium advice service, and are unlikely to offer guidance only services to any significant extent. This was the view taken in the consultation response from the Association of Professional Financial Advisers, which said that altering the definition will make little difference to existing financial advisers.

Direct Monetised Benefits

Firms not currently providing personal recommendations

42. Firms set out the benefits they would expect from our narrowing and clarifying the definition of financial advice both in response to the Financial Advice Market Review Call for Input, which received 268 responses, and the consultation on Amending the Definition of Financial Advice specifically, which received 63 responses.

43. Firms told us that the main monetised benefit expected is a reduction in the costs of ensuring that the firm does not inadvertently cross the boundary into regulated financial advice. Firms are of the opinion that 'giving a personal recommendation' is a less subjective definition than 'advising on investments'. This is because firms do not have to assess whether they are providing factual information on particular investments, or moving beyond that into more tailored guidance on the merits and risks associated with those investments. Firms reported that they would therefore be able

to reduce their spending on internal controls to ensure compliance with the boundary. Areas where benefits could be realised include:

- Staff time: time spent monitoring staff communications or other communications with retail customers to ensure that they do not constitute regulated advice
- External Costs: advice from legal and compliance experts.

44. We have estimated the expected savings to firms using figures provided to us by a range of stakeholders.

45. All firms who have dealings with retail customers have the potential to benefit from reduced compliance spend. However, the above figures are sensitive to a number of factors.

    - **Firm Risk Appetite**: There could be a potentially large variation based on firm risk appetite. Measuring risk appetite is complex and not proportionate for a light touch impact assessment. Some firms who responded to the consultation stated that they would make no changes to their existing compliance mechanisms. These firms would receive no benefit. Therefore, we have accounted for 30% of firms not currently providing personal recommendations receiving no monetary benefit from this change due to a higher level of risk aversion. We have assumed, however, that most firms will attempt to realise the potential compliance savings.
    - **Clarity of FCA guidance:** A significant number of firms who responded to the consultation felt unable to give an estimate of expected direct benefits until they see the guidance the FCA will produce alongside this change. This is because the clearer the FCA's guidance, the more confidence firms will have in where the new boundary lies.
    - **Firm size and business model:** Firms who interact with higher numbers of customers, or have a greater level of interaction with their customers, are likely to benefit more from reduced compliance costs.

Firms currently providing personal recommendations

46. Firms currently providing personal recommendations as their main activity are not generally expected to receive substantial monetary benefits from this change.

47. Firms who conduct initial guidance conversations with clients before they enter into a full advice process may receive a monetary benefit from less rigorously policing the content of these conversations. They may also benefit from less rigorous policing of advertising material.

48. However, as these conversations are likely to be conducted by qualified IFAs, who have a good understanding of where the advice boundary lies, financial advice firms are less likely to use formal controls with associated costs to monitor these conversations than firms who do not currently provide personal recommendations. Additionally, as the majority of advice firms employ under 5 financial advisers, these firms are likely to have a significantly smaller compliance spend than firms who do not currently provide personal recommendations. Another important factor is that firms in this category tend to be more risk averse than firms not currently providing personal recommendations. This is due to a perception in the market (that became apparent in responses to the Financial Advice Market Review) that there is a high risk of a successful consumer claim for bad advice through the Financial Ombudsman Service.

49. Therefore, in the figures below we have accounted for 90% of firms currently providing personal recommendations receiving no monetary benefit. (This is in addition to 30% of firms not currently providing personal recommendations receiving no monetary benefit due to risk aversion)

50. Table 3 represents savings to firms from a reduction in monitoring costs. These are given in terms of how many Full Time Equivalent (FTE) staff would no longer need to work on monitoring compliance. Low and high estimates for the reduction in FTE staff needed are again based on the lowest and highest estimates provided by firms. The best estimate is the middle point. Firms also provided the

total employment costs for one FTE member of staff. We have again taken the lowest and highest FTE employment costs provided and used the middle figure as our best estimate.

Table 3: Savings to firms in Year 1 from a reduction in monitoring costs

Reduction in monitoring costs:	Low Estimate	High Estimate	Best Estimate
FTE reduction	0.1	2	0.95
FTE Cost	£34,438	£105,800	£67,500
Total Reduction per firm:	£3,444	£211,600	£64,125
Overall reduction:	£20,825,692	£1,279,608,680	£387,783,113

51. Table 4 shows savings firms expect to receive from a reduction in external legal and compliance spend (e.g. consultations with lawyers and compliance experts). The low and high estimates are based again on the lowest and highest estimates given by firms. The best estimate is a figure in the lower part of the range. This is to account for the fact that the high estimate is much higher than the savings that were expected by respondents to the consultation, so is likely to be an outlier.

Table 4: Savings to firms in Year 1 from a reduction in external compliance/legal spend

	Low Estimate	High Estimate	Best Estimate
Reduction in external compliance/legal spend:	£1,000	£44,000	£5,000
Overall reduction:	£6,047,300	£266,081,200	£30,236,500

Table 5: Overall Savings to Firms in Year 1

Overall Savings per firm:	£4,444	£255,600	£69,125
Total Overall Savings:	£26,872,992	£1,545,689,880	£418,019,613

Sensitivity Analysis

52. We have conducted a sensitivity analysis of how the percentage of firms receiving no monetary benefit affects the overall impact on firms. This sensitivity analysis takes the best estimates for impacts on firms, given varying assumptions about the percentage of firms that will benefit. This demonstrates that even using cautious assumptions of how many firms will realise benefits, our best estimate of the net impact on firms is still positive.

Table 6:

	Low Estimate	High Estimate	Best Estimate
Advice Firms Receiving No Benefit (%)	80%	100%	90%
Other Firms Receiving No Benefit (%)	20.00%	40%	30%
Total Benefit to Firms	£503,285,300	£332,753,925	£418,019,613
Total Impact on Firms in Year 1	£474,692,770	£304,161,395	£389,427,083
Total Impact on Firms over 10 Years	£5,004,260,470	£3,298,946,720	£4,151,603,595

Non-monetised benefits

53. The main rationale that respondents to both consultations gave for this change were a number of important non-monetised benefits. These benefits are expected to motivate firms to adapt their business models to give more guidance to consumers.

54. The change will give firms the confidence to provide more financial guidance to their customers, as it will become clearer when help will and will not cross the boundary into regulated financial advice. It will also allow firms to provide guidance on the merits and risks associated with buying their particular financial products.

55. Additional guidance will result in a direct benefit to consumers. Consumers will receive more help when purchasing financial products. This will have two important effects:

- Consumers are more likely to choose financial products that are appropriate for them.
- Consumers are more likely to purchase a financial product overall; consumers are more likely to have the confidence to invest their money, which will most likely benefit them in a low interest rate environment.

These effects cannot be monetised, as the extent to which these effects will be realised depends heavily on both firm business models and consumer behaviour.

56. Some firms who responded to the consultation stated that they would be motivated to change their business models to provide more guidance simply by a desire to help their customers make better financial decisions.

57. There are also potential monetary benefits to firms offering more guidance to their customers:

- Consumers are likely to perceive the customer service of firms who provide more guidance to be better than their competitors who provide less guidance. This means that firms may be more likely to attract and retain customers if they provide guidance. This is backed up by anecdotal evidence from the FAMR consultation; firms reported that consumers often get frustrated if firms are unable or unwilling to answer their questions due to the regulatory risk associated.
- Consumers are more likely to purchase a product from a firm if they have received high quality guidance, giving them confidence in their decision when selecting a product. Higher confidence when shopping for a product is likely to result in more sales.

Again, these effects cannot be quantified, as the extent to which they could be realised depends heavily on both firm business models and consumer behaviour. However, as stated above, as this is an enabling measure, it is reasonable to assume that if a firm chooses to provide more guidance to their customers, the benefits of doing so will be at least equal to the costs.

Evidence

58. This is a light touch impact assessment on the basis that the measure is deregulatory. This is because firms will require less compliance monitoring in order to avoid crossing the boundary from guidance to advice when offering help to consumers.

59. The consultation document attempted to collect evidence from firms of the extent of the cost and benefits they would face. However, many firms felt unable to quantify the costs and benefits without seeing the FCA's guidance on the change. They made the point that the definition alone does not provide reassurance about how the FCA will interpret and apply the new definition. For this reason, limited evidence was collected during the consultation period.

60. To supplement the evidence provided by firms in response to the consultation, we contacted 5 of firms of different sizes and with different business models and asked them to provide us with detailed

estimates of the likely costs and benefits to their business, assuming that the FCA's guidance delivers sufficient clarity on the change.

61. Collecting further evidence and conducting further analysis would not be proportionate because;

- This measure is deregulatory, so is expected to have a net positive impact on firms.
- The estimates given to us by firms show that the direct benefits to firms are likely to be significantly higher than the direct costs. Therefore, we are confident that net benefits to firms will outweigh net costs, even given uncertainties. The low estimate outcome is highly unlikely to be realised.
- Although our estimates of direct benefits to firms are based on a small evidence base, we do not think that collecting more evidence from firms is likely to significantly increase the accuracy of our estimates. The likely costs and benefits to firms vary in extremely complex ways based on their current business models, likely changes to their business models and risk appetites. Due to the lack of data available about these factors, it would be very difficult for us to collect evidence from a sample of the relevant population that would be statistically significant. Therefore, collecting more data from firms is unlikely to significantly increase the overall accuracy of our estimates.

Risks and assumptions

62. **Population of firms:** It is assumed that banks, building societies, life insurers, general insurance intermediaries and personal investment firms all have a significant level of interaction with retail investors. However, variation in business models may mean that this is not the case for all firms.

63. **Direct costs:** It is assumed that familiarisation costs will not vary dramatically based on the size of a firm. This is because the costs of a regulatory assessment and adjustments to standard templates do not necessarily increase proportionally to firm size.

64. **Firm size and business model:** We have not specifically accounted for these factors. However, given dramatic difference between size of costs and size of benefits for individual firms, have assumed that when size varies, benefits will still outweigh costs. On our best estimate, benefits outweigh costs by £66,807 per firm in the first year. Therefore, we have assumed that these variables will not change the policy from a net positive impact.

65. **Risk appetite:** We have accounted for 30% of firms not currently providing personal recommendations not receiving any benefit. This accounts for firms who do not change their compliance mechanisms due to risk aversion. A sensitivity analysis has been conducted (Table 6).

66. **Unauthorised firms:** We have assumed that unauthorised firms will not incur any costs or receive any benefits as a result of this change. Unauthorised firms currently do not have permission to give financial advice or detailed guidance services currently caught by the RAO. This will remain the case. If an unauthorised firm wishes to change their business model to undertake these activities, they will need to apply for FCA authorisation.

Other Impacts

67. **Equalities**

The government expects the equalities impact of this measure to be neutral. Religion, gender, pregnancy and maternity, race and sexual orientation do not generate significant issues in terms of financial advice. It could be argued that older people are likely to be better placed to access regulated financial advice, so this measure may benefit younger generations to a greater extent.

68. **Impact on small firms and micro-business**

This impact assessment has considered the impacts on small firms and micro-business. The relevant small firms are financial advice firms, who are currently providing personal recommendations. These firms are included in our analysis above.

These firms will face small familiarisation costs, which are likely to be at the lower end of the range of estimates we have provided. This assumption is based on consultation responses from networks representing small advice firms. For example, the Association of Professional Financial Advisers did not raise costs as an issue in their consultation response.

Summary and implementation plan

Summary of Impacts

Table 7: Total Impact on Firms over 10 years

	Worst Outcome	Best Outcome	Best Estimate
Total Impact on Firms in Year One:	-£23,700,508	£1,537,992,840	£389,427,083
Total Impact on Firms Ongoing Annual Average:	£26,872,992	£1,545,689,880	£418,019,613
Total Impact on Firms over 10 years	£218,156,417.40	£15,449,201,760	£4,151,603,595

69. Table 6 shows the overall impacts on firms based on Tables 1-5. The worst outcome (calculated by subtracting the high estimate for costs to firms from the low estimate of benefits to firms) results in a net cost to businesses in the first year, but a net benefit over a 10 year period. The best estimate results in a net benefit both in the first year, and over a 10 year period.

Implementation

70. The FCA will produce a short explanatory note that will be published when the statutory instrument to implement the change is laid. This will set out the regulatory impacts on firms, allowing them to prepare for the implementation of the change.

71. The statutory instrument will contain an ‘activation clause’. The change will come into effect on 3 January 2018. This is the same day that MIFID II will be implemented. Aligning the changes will reduce burdens on firms by allowing them to make all documentation/process changes at the same time. It will also give the FCA time to consult on and publish new guidance on the advice boundary.